

Message Text

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TAGS: EFIN, EEC

SUBJECT: UK ECONOMIC SITUATION--EC COMMISSION QUITELY READY
TO ASSIST IN STABILIZATION PROGRAM

REF: EC BRUSSELS A-191, MAY 21, 1975

1. BEGIN SUMMARY: THE EC COMMISSION HAS PREPARED A CLOSELY-HELD ASSESSMENT OF THE OUTLOOK OF THE UK ECONOMY AND POSSIBLE UK ECONOMIC STABILIZATION MEASURES. OFFICIALS HERE ARE DEEPLY CONCERNED OVER THE UK'S ECONOMIC TRENDS BUT BELIEVE THE UK CAN REGAIN ECONOMIC EQUILIBRIUM IF STRINGENT MEASURES ARE UNDERTAKEN. THE COMMISSION IS PREPARED TO ASSIST IN A STABILIZATION PROGRAM IN THE EC CONTEXT BUT SO FAR UK AUTHORITIES HAVE NOT ASKED FOR ITS HELP. END SUMMARY.

2. EC COMMISSION FINANCIAL OFFICIALS HAVE BEEN PREPARING A CONFIDENTIAL ANALYSIS OF THE UK'S ECONOMIC SITUATION AND OF POSSIBLE MEASURES WHICH THE EC COULD UNDERTAKE TO ASSIST THE UK IN STABILIZING ITS ECONOMY. OFFICIALS HERE EXPECT THE UK TO ADOPT STRINGENT ECONOMIC MEASURES, PERHAPS BY AS EARLY
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AS SEPTEMBER. THEY BELIEVE A STABILIZATION PROGRAM SHOULD

CONTAIN AT LEAST TWO MAIN ELEMENTS: (1) A STATUTORY INCOMES POLICY, AND (2) A REDUCTION IN GOVERNMENTAL EXPENDITURES. COMMISSION OFFICIALS EXPECT EFFORTS TO INVOKE SELECTIVE TRADE RESTRICTIONS SUCH AS QUOTAS ON MOTOR VEHICLE IMPORTS IN ORDER TO HELP SHORE UP ITS BALANCE OF PAYMENTS SITUATION. CHANCELLOR HEALEY, THEY BELIEVE, IS DETERMINED TO RESIST SUCH RESTRICTIONS. THE UK MAY, HOWEVER, USE THE THREAT OF RESTRICTIVE MEASURES TO GAIN EC ASSISTANCE FOR ITS BALANCE OF PAYMENTS PROBLEMS.

3. THE UK HAS NOT ENTERED INTO SUBSTANTIVE DISCUSSIONS WITH THE COMMISSION REGARDING A POSSIBLE STABILIZATION PROGRAM. COMMISSION VICE PRESIDENT HAFERKAMP IS SCHEDULED TO MEET WITH HEALEY SHORTLY TO DISCUSS THE UK SITUATION. COMMISSION OFFICIALS BELIEVE IT WOULD BE POLITICALLY MORE PALATABLE FOR THE UK TO ENTER INTO A STABILIZATION AGREEMENT WITH THE IMF THAN WITH THE COMMUNITY. THE BRITISH PUBLIC HAS EXPERIENCE WITH ECONOMIC CONDITIONS IMPOSED BY THE IMF BUT WOULD LIKELY REACT ADVERSELY TO THE COMMUNITY IMPOSING CONDITIONS. ON THE OTHER HAND, UK AUTHORITIES HAVE INDICATED AN INTEREST IN POSSIBLY BORROWING FROM THE EC COMMON BORROWING FACILITY AND ITS MEDIUM-TERM CREDIT FACILITY. BOTH FACILITIES REQUIRE THAT ECONOMIC CONDITIONS BE IMPOSED. IN CASE OF A SHORT-RUN LIQUIDITY PROBLEM, THE UK COULD ALSO TURN TO THE EC SHORT-TERM CREDIT FACILITY. COMMISSION OFFICIALS BELIEVE ANY COMMUNITY CONDITIONS MIGHT BE DEVELOPED IN TANDEM WITH AN IMF STAND-BY AGREEMENT AND COULD BE GENERAL IN NATURE SO AS TO MINIMIZE POSSIBLE PUBLIC CRITICISM. IN ANY CASE, AS THE PRESENT TIME THE UK HAS NOT ASKED THE COMMISSION TO CONSIDER A POSSIBLE EC STABILIZATION PROGRAM.

4. COMMISSION FINANCIAL OFFICIALS ARE DEEPLY CONCERNED OVER THE UK'S ECONOMIC SITUATION. THEY BELIEVE THE UK IS CAPABLE OF CORRECTING ITS ECONOMIC DISEQUILIBRIUM BUT THE SOCIAL COSTS WILL BE HIGH, BECAUSE OF INCREASED UNEMPLOYMENT AND REDUCED PRIVATE CONSUMPTION. BRITISH INSTITUTIONS ARE CONSIDERED TO BE STRONG ENOUGH TO WITHSTAND PUBLIC OPPOSITION TO RESTRICTIVE POLICIES. THE ADJUSTMENT PROCESS WILL BE PAINFUL, HOWEVER, BECAUSE THE ECONOMY BADLY NEEDS TO BE RESTRUCTURED AND THIS WILL REQUIRE SEVERAL YEARS.

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5. COMMISSION EXPERTS HAVE UPDATED THEIR MACRO-ECONOMIC ANALYSIS OF THE UK (SEE REF MESSAGE) IN LIGHT OF THE SLUGGISH PERFORMANCE OF THE FRG ECONOMY AND THE DELAY IN THE UPTURN OF THE US ECONOMY. IN FACT, THE COMMISSION HAS NOW REVISED DOWNWARD ITS PROJECTION OF THE FRG ECONOMY TO A DECLINE OF AT LEAST 1 PERCENT IN REAL GNP GROWTH FOR 1975. AS A RESULT, THE UK ECONOMY IS EXPECTED NOW TO SHOW NO REAL GROWTH FOR

1975 AND 1976.

6. THE COMMISSION PROJECTS THAT THE UK WILL RUN A BOP DEFICIT ON CURRENT ACCOUNT OF ABOUT \$7 BILLION FOR BOTH 1975 AND 1976 COMPARED TO A DEFICIT OF ABOUT \$8.9 BILLION LAST YEAR. CONSUMER PRICES ARE LIKELY TO INCREASE AN AVERAGE OF CLOSE TO 25 PERCENT THIS YEAR AND, IF PRESENT POLICIES CONTINUE, AT LEAST 20 PERCENT NEXT YEAR. BECAUSE OF THE ECONOMIC STAGNATION AND DISEQUILIBRIUM, UNEMPLOYMENT IS PROJECTED TO RISE FROM A SEASONALLY-ADJUSTED FIGURE OF 765,000 IN MARCH TO ABOUT 1,250,000 BY THE FIRST QUARTER NEXT YEAR. THE PUBLIC SECTOR IS EXPECTED TO GROW IN VOLUME TERMS BY ABOUT 5 PERCENT THIS YEAR. ON THE OTHER HAND, PRIVATE INVESTMENT IS ESTIMATED TO DECLINE BY 10 PERCENT THIS YEAR AND 5 PERCENT NEXT YEAR. COMMISSION OFFICIALS SAY THESE TRENDS HIGHLIGHT THE CENTRAL STRUCTURAL PROBLEM: THE NEED TO TRANSFER RESOURCES OUT OF THE INEFFICIENT PUBLIC SECTOR AND INTO PRODUCTIVE ENDEAVORS, ESPECIALLY EXPORT INDUSTRIES. GREENWALD

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